Social Security Retirement Income Basics

The largest government program today, the Old Age, Survivors and Disability Insurance (OASDI) Program, more commonly referred to as "Social Security," is a tax-based initiative designed to provide income to individuals who are no longer able to work.

Through either taxes or distributions, Social Security income affects everyone. It can be a powerful tool for retirees and can greatly affect the flexibility of a person's future. Every person should understand how it works and what payments he or she is able to receive.

How Does it Work?

There is some popular confusion about how Social Security income works. It is not a forced retirement savings account created by the government. Social Security is a constant flow of tax money that is taken from current workers, placed into a trust fund and distributed to qualifying individuals who are in need. It was created during the Great Depression as a way for government to help those who could not work but desperately needed support.

Payroll employees are taxed for Social Security as long as they have income. Provided they have worked 40 fiscal quarters (equivalent to 10 years, non-consecutive), they are entitled to begin receiving retirement payments from the program. Since the Social Security tax is proportional to income, those with higher incomes pay more into the program, and, consequently, are given higher payments when they retire.

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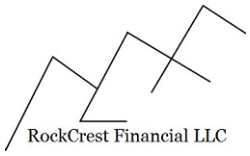
What Affects Payment?

Though income (averaged from 35 years of highest pay) is the groundwork for determining a person's Social Security benefits, numerous factors can change the benefit amount. If not planned for correctly, retirees may forfeit money that was theirs for the taking.

Age

Probably the biggest factor, a person's age greatly shifts the rate at which funds are distributed. The Social Security Administration (SSA) considers full retirement age to be 66 (or 67 if born after 1954). Though a person can begin receiving benefits at age 62, early use of Social Security will decrease his or her monthly payments. If the individual delays taking benefits, the monthly payment will steadily increase (70 is the maximum age to delay.) Monthly amounts increase because the SSA makes calculations using the average national lifespan; even though monthly payments may be different, the estimated total benefit amount does not change much. Delaying payments until age 70 will



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eventually accumulate to a higher total value, but the retiree will have to survive until about age 85 before they reach that tipping point.

Spousal Benefits

When a couple reaches retirement a spouse may choose either to have his or her benefit calculated normally or have it be set at 50 percent of the spouse's full retirement benefit. This gives a greater benefit to couples where one spouse earned considerably more than the other. Not surprisingly, the monthly spousal benefit amount is reduced if the spouse takes them before his or her full retirement age; however, the rate does not increase for waiting beyond that point.

Note: A divorced spouse remains eligible for this 50 percent benefit, provided the marriage lasted 10 years and he or she has not remarried.

If one spouse dies, the survivor is entitled to take the deceased's Social Security benefit instead of his or her own. This full amount is available when the survivor reaches full retirement age, but benefits can be claimed as early as age 60 (age 50 if disabled). Like other cases, early benefits will decrease payment amount.

Note: A surviving divorced spouse also remains eligible for this full claim, provided the marriage lasted 10 years and the survivor did not remarry before age 60 (age 50 if disabled.)

Income and Taxes

It is important that retirees plan out how Social Security will coincide with retiring from the workforce. Reductions can occur if a working individual takes early benefits while earning significant income. For every $2 of income earned above an annual limit ($15,720 in 2016), $1 will be removed from an individual's Social Security benefit for that year. On the year full retirement age is reached, the deduction drops to $1 for every $3 earned over a higher limit ($41,880 in 2016). After full retirement age is reached, no deductions are made.

Retirees should also be aware that Social Security benefits will be taxed if their total retirement income is too high. The taxation rate is determined by "combined income," which is made up of adjusted gross income, nontaxable interest and half the value of the Social Security benefit amount. If the income limits are crossed, either 50 or 85 percent of the Social Security benefit will subject to income tax. Approximately one-third of people pay some tax on their Social Security benefits.

Planning with Social Security in Mind

Social Security benefits are based on formulas and tables that are publically available. Using a basic online calculator (e.g. www.socialsecurity.gov), it is easy for anyone to get an estimate of what his or her benefit will be. Planning for retirement is much simpler when all sources of income can be taken into account.

Unfortunately, the future of Social Security benefits is very unclear right now. Adjustments to inflation calculations and benefit cuts seem to be constantly under discussion in Congress. Current estimates predict that Social Security will become underfunded in as little as 20 years. If nothing is changed before then, direct reductions will be made to benefit payments. It is hoped that no such reductions will have to be made, but it is important for individuals to recognize that they should not allow their retirement plans to be overly reliant on Social Security benefits.

Though the general rules for determining Social Security benefits are simple, they overlap to create unique and complex situations for beneficiaries. It is important to establish a clear Social Security strategy with your retirement planning, especially if you are married or expect Social Security to be a big part of your retirement income. Contact RockCrest Financial LLC to make sure your personal situation will make efficient use of every available benefit.